

(i) That the rent or other compensation received was the highest obtainable, or if none was received, that none was obtainable;

(ii) That the property was held in the course of a business carried on bona fide for profit; and

(iii) Either that there was reasonable expectation that the operation of the property would result in a profit, or that the property was necessary to the conduct of the business.

(2) The burden of proof will rest upon the taxpayer to sustain the deduction claimed. If a United States shareholder, in computing his distributive share of undistributed foreign personal holding company income to be included in gross income in his individual return (see section 551, and §§ 1.551-1 and 1.551-2), claims deductions for expenses and depreciation allocable to the operation and maintenance of property owned or operated by the company, in an aggregate amount in excess of the rent or other compensation received for the use of, or the right to use, the property, he shall attach to his income tax return a statement setting forth his claim for allowance of the additional deductions, together with a complete statement of the facts and circumstances pertinent to his claim and the arguments on which he relies. Such statement shall set forth:

(i) A description of the property;

(ii) The cost or other basis to the corporation and the nature and value of the consideration paid for the property;

(iii) The name and address of the person from whom the property was acquired and the date the property was acquired;

(iv) The name and address of the person to whom the property is leased or rented, or the person permitted to use the property, and the number of shares of stock, if any, held by such person and the members of his family;

(v) The nature and gross amount of the rent or other compensation received for the use of, or the right to use, the property during the taxable year and for each of the five preceding years and the amount of the expenses incurred with respect to, and the depreciation sustained on, the property for such years;

(vi) Evidence that the rent or other compensation was the highest obtainable, or, if none was received, a statement of the reasons therefor;

(vii) A copy of the contract, lease or rental agreement;

(viii) The purpose for which the property was used;

(ix) The business carried on by the corporation with respect to which the property was held and the gross income, expenses, and taxable income derived from the conduct of such business for the taxable year and for each of the five preceding years;

(x) A statement of any reasons which existed for expectation that the operation of the property would be profitable, or a statement of the necessity for the use of the property in the business of the corporation, and the reasons why the property was acquired; and

(xi) Any other information pertinent to the taxpayer's claim.

(f) *Taxes and contributions to pension trusts.* Section 164(e) provides for deduction by a corporation for taxes of a shareholder paid by it; section 404 provides for deduction by an employer for its contributions to an employees' trust, etc. For the purpose of computing undistributed foreign personal holding company income, neither of these deductions is allowable.

[T.D. 6500, 25 FR 11737, Nov. 26, 1960, as amended by T.D. 7207, 37 FR 20796, Oct. 5, 1972]

**§ 1.556-3 Illustration of computation of undistributed foreign personal holding company income.**

The method of computation of the undistributed foreign personal holding company income may be illustrated by the following example:

*Example.* (a) The following facts exist with respect to the M Corporation, a foreign personal holding company, for the calendar year 1954:

(1) The gross income of the corporation as defined in section 555 amounts to \$300,000, of which \$85,000 represents its distributive share of the undistributed foreign personal holding company income of another foreign personal holding company in which it is a shareholder, \$200,000 consists of dividends, \$10,000 consists of fully taxable interest, and the remainder (\$5,000) consists of rent received from the principal shareholder of the

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corporation for the use of property owned by the corporation.

(2) The expenses of the corporation amount to \$85,000, of which \$75,000 is allocable to the maintenance and operation of the property used by the principal shareholder and \$10,000 consists of ordinary and necessary office expenses allowable as a deduction. The claim for deduction for the expenses of, and depreciation on, the rented property in excess of the rent received for its use is not established as provided in section 556(b)(5). The yearly depreciation on the rented property amounts to \$30,000.

(3) Federal income tax withheld at the source on the income of the corporation from sources within the United States amounts to \$59,125.

(4) No gain from the sale or exchange of stock or securities is realized during the taxable year, but losses in the amount of \$10,000 are sustained from the sale of stock or securities which constitute capital assets. Such losses are not allowed as a deduction in any amount. See section 1211(a).

(5) Contributions, payment of which is made to or for the use of donees described in section 170(b)(1)(A) for the purposes therein specified, amount to \$15,000, of which \$5,000 is deductible in computing taxable income under section 63.

(6) Dividends paid by the corporation to its shareholders during the taxable year amount to \$50,000.

(b) The taxable income of the corporation (including the distributive share of the undistributed foreign personal holding company income of the other foreign personal holding company) is \$180,000, computed as follows (assuming for the purposes of this example only that the expenses of, and depreciation on, the rental property are deductible under sections 162 and 167):

<i>Income (Section 61)</i>	
Dividends .....	\$200,000
Interest .....	10,000
Rent .....	5,000
<b>Gross income as defined in section 61</b> .....	<b>215,000</b>
<b>Add:</b>	
Distributive share of undistributed income of the other foreign personal holding company (considered as a dividend) .....	85,000
<b>Gross income as defined in section 555</b> .....	<b>300,000</b>
<i>Deductions (Section 161)</i>	
Expenses allocable to operation of the rented property .....	\$75,000
Depreciation of the rented property .....	30,000
Ordinary and necessary expenses (office) .....	10,000
Contributions (within the 5-percent limitation specified in section 170(b) (2)) .....	5,000
<b>Total deductions</b> .....	<b>120,000</b>
<b>Taxable income for purposes of computing undistributed foreign personal holding company income</b> .....	<b>180,000</b>

(c) The undistributed foreign personal holding company income of the corporation is \$160,875, computed as follows:

Taxable income for purposes of computing undistributed foreign personal holding company income .....	\$180,000
<b>Add (see section 556(b)):</b>	
Contributions deductible in computing taxable income under section 63 .....	5,000
Excess property expenses and depreciation over amount of rent received for use of property (\$105,000 - \$5,000) .....	100,000
<b>Total</b> .....	<b>105,000</b>
<b>Deduct (see section 556(b)):</b>	
Federal income taxes .....	59,125
Contributions (within the percentage limitations specified in section 170(b)(1) (A) and (B), determined under the rules provided in section 556(b)(2)) .....	15,000
<b>Total</b> .....	<b>74,125</b>
<b>Net additions under section 556(b)</b> .....	<b>30,875</b>
<b>Taxable income, as adjusted under section 556(b)</b> .....	<b>210,875</b>
<b>Less: Deduction for dividends paid (see section 561)</b> .....	<b>50,000</b>
<b>Undistributed foreign personal holding company income</b> .....	<b>160,875</b>

### DEDUCTION FOR DIVIDENDS PAID

#### § 1.561-1 Deduction for dividends paid.

(a) The deduction for dividends paid is applicable in determining accumulated taxable income under section 535, undistributed personal holding company income under section 545, undistributed foreign personal holding company income under section 556, investment company taxable income under section 852, and real estate investment trust taxable income under section 857. The deduction for dividends paid includes:

(1) The dividends paid during the taxable year;

(2) The consent dividends for the taxable year, determined as provided in section 565; and

(3) In the case of a personal holding company, the dividend carryover computed as provided in section 564.

(b) For dividends for which the dividends paid deduction is allowable, see section 562 and § 1.562-1. As to when dividends are considered paid, see § 1.561-2.

[T.D. 6500, 25 FR 11737, Nov. 26, 1960, as amended by T.D. 6598, 27 FR 4093, Apr. 28, 1962]